

DEPARTMENT OF STATE REVENUE

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FIRST SUPPLEMENTAL LETTER OF FINDINGS NUMBER: 96-0375 ST

Sales And Use Tax

For The Periods: 1992 Through 1994

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ISSUES

VI. Sales/Use Tax - Specialized Ladders and Platforms

Authority: 45 IAC 2.2-5-8

The taxpayer protests the assessment of use tax on several items of quality control.

VII. Sales/Use Tax - Quality Control

A. Unscramblers and Hoppers

Authority: IC 6-2.5-5-3; 45 IAC 2.2-5-8; Chrome Deposit Corp. v. Indiana Dept. Of State Revenue, 557 N.E.2d 1110, 1118 (Ind. Tax 1990).

The taxpayer protests the assessment of use tax on unscramblers and hoppers.

F. Specialized Doors

Authority: IC 6-2.5-5-3; Department of State Revenue v. Kimball International, Inc., 520 N.E.2d 454 (Ind. App. 1988)

The taxpayer protests the assessment of use tax on installed specialized doors.

X. Negligence Penalty - Imposition

Authority: I.C. 6-8.1-10-2.1; 45 IAC 15-11-2

Taxpayer protests the imposition of the ten percent (10%) negligence penalty.

STATEMENT OF FACTS

This Letter of Findings supplements the original Letter of Finding issued September 2, 1997. Issues VI, VII A, VII F, and X are the only issues affected by this Supplemental Letter of Findings. All other issues addressed in the Letter of Finding issued September 2, 1997, stand as originally written.

VI. Sales and Use Tax - Specialized Ladders and Platforms

DISCUSSION

Taxpayer has specialized ladders and platforms ("ladders") to allow workers access to the machinery. The taxpayer has ladders to allow production operators access to mixers, blenders, boilers, and other production equipment which are not accessible from the floor or otherwise safely accessible. (Taxpayer letter Nov. 19, 1996) The taxpayer argues that the ladders constitute an essential and integral part of the production process. In support of this, the taxpayer contends that the platforms and ladders are similar to the workbench example in 45 IAC 2.2-5-8 (c)(2)(E). This regulation provides, "The following types of equipment constitute essential and integral parts of the production process... A work bench used in conjunction with a work station or which supports production machinery within the production process."

Even if it is assumed that the ladders are analogous to a workbench bench, in order to qualify for the exemption they must be clearly within the production process. The Department refers to 45 IAC 2.2-5-8 (g):

Components parts of a unit of machinery or equipment, which unit has an immediate effect on the article being produced, are exempt if such components are an integral part of such manufacturing unit. The fact that particular property may be considered essential to the conduct of the business of manufacturing because its use is required by either law or practical necessity does not itself mean that the property "has an immediate effect upon the article being produced". Instead, in addition to being essential for one of the above reasons, the property must also be an integral part of an integrated process which produces tangible personal property.

The taxpayer has provided the Department a video tape which shows how the ladders are used. The ladders do allow the employees the opportunity to reach the line in production, and as the video shows, the production line is several feet from the ground. The taxpayer states the ladders allow the workers to gain access to the line in case of a jam. The Department views the process of clearing jams as a maintenance activity rather than one of production. As a consequence, the Department finds that the ladders exist for maintenance purposes rather than to allow the operators to engage in production. The ladders may exist for practical necessity but do not have an immediate effect on the property being produced. The ladders are not an integral part of the production process.

FINDING

The taxpayer's protest is denied. The specialized ladders and platforms are not exempt from use tax.

VII. Sales and Use Tax - Quality Control

DISCUSSION

A. Unscramblers and Hoppers

The taxpayer's assembly line begins with automated hoppers. The hoppers store the bottles, cans, and caps until it automatically sends them onto the production line. The taxpayer makes an analogy between the hoppers and a fuel tank. Like a fuel tank, the hoppers store a product and then inject it into production as needed.

After the hopper sends the bottles, cans and caps to the beginning of the production process, the unscramblers then automatically align and clean the bottles, cans, and caps. In addition, the unscramblers will also remove the can or bottle from the line if it is the wrong size. The video supplied by the taxpayer shows how the unscramblers and hoppers are incorporated into the production line.

The Indiana Administrative Code states in 45 IAC 2.2-5-8 (d) which states:

Pre-production and post-production activities. "Direct use in the production process" begins at the point of the first operation or activity constituting part of the integrated production process and ends at the point that the production has altered an item to its completed form, including packaging, if required.

The unscramblers are at the beginning of the production stage and act they have a direct effect on the product by cleaning it. As the taxpayer argues, the Tax Court recognized an exemption for "equipment used in the cleansing process" in Chrome Deposit Corp. v. Indiana Dept. Of State Revenue, 557 N.E.2d 1110, 1118 (Ind. Tax 1990). The Department finds that the unscramblers, which clean, sort, align, and check for contaminants qualify for the manufacturing exemption.

The Department has determined that the integrated production process begins with the unscramblers, the hoppers acts as a loader which is a pre-production step. The hoppers are not entitled to the manufacturing exemption.

F. Specialized Doors - The taxpayer purchased and installed specialized doors to separate production areas from corridors and the warehouse. The purpose of the installation was to prevent contamination and to minimize damage to the product by controlling humidity during production.

The taxpayer states that they must use these doors to ensure the product's safety because it is being produced for consumption by human(s).

The doors act as a seal to prevent air flow from chemicals in the adjacent manufacturing area. The doors operate in a way that when one enters a door there is a holding area in which the occupant will remain until the first door closes; once the first door closes, the second unlocks and allows the person to go through.

The auditor agrees that the doors help in the prevention of product contamination and control humidity, but the auditor stated that the exemption was lost because it became part of real property. The taxpayer argues that 45 IAC 2.2-5-6 (e)(2) expressly recognizes that property incorporated into realty is exempt if purchased for direct use in the production process. This regulation states that property incorporated into realty becomes real property, unless it is directly used in the production process. If the property is directly used in the production process, it remains tangible personal property.

The question now focuses on whether the doors are directly used in the production process. The taxpayer compares their situation to Department of State Revenue v. Kimball International, Inc., 520 N.E.2d 454 (Ind.App. 3 Dist. 1988). In Kimball, the taxpayer sought an exemption for air make-up units consisting of fans, filters, heaters and duct work; this created an airflow to heat, bring in outside air, and control humidity. This operation functioned to protect the product from damage by creating an airflow that was essential to the manufacturing process. These units acted directly on the product by preventing dust particles to settle on the freshly applied finish.

The specialized door is distinguishable from the exempt air make up units found in Kimball. This door acts as a buffer zone between the production areas. The doors do not actively change the environment or affect the production process like the air make up units found in Kimball. The doors are not directly used in the production process because it does not have a direct effect on production. Therefore, the taxpayer is not eligible for the exemption found in 45 IAC 2.2-5-6 (e)(2).

FINDING

The taxpayer's protest is partially sustained and partially denied. The Department finds that the unscramblers qualify for the manufacturing exemption but the hoppers do not.

The taxpayer's protest is denied as to the specialty doors. The Department finds that the specialty doors do not qualify for the manufacturing exemption.

X. Tax Administration - Penalty

DISCUSSION

Taxpayer protests the imposition of the ten percent (10%) negligence penalty. The negligence penalty imposed under IC 6-8.1-10-2.1(e) may be waived by the Department where reasonable cause for the deficiency has been shown by the taxpayer. Specifically:

The department shall waive the negligence penalty imposed under IC 6-8.1-10-2 if the taxpayer affirmatively establishes that the failure to file a return, pay the full amount of tax due, timely remit tax held in trust, or pay a deficiency was due to reasonable cause and not due to negligence. In order to establish reasonable cause, the taxpayer must demonstrate that it exercised ordinary business care and prudence in carrying out or failing to carry out a duty giving rise to the penalty imposed under this section. 45 IAC 15-11-2(e).

The taxpayer demonstrated ordinary business care and prudence in their interpretation of the statutes. Also, after the audit and a Claim for Refund, it was determined that the taxpayer had actually overpaid use tax to the Department during the audit period. The taxpayer is only entitled to a refund for two of the three years, because the statute of limitations had already expired for 1992. The penalty will be waived.